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# REAL ESTATE OUTLOOK

*Vol. 1, No. 5* *May 1988*

*A Monthly Forecast for the Economy and Real Estate*

## FORECAST SUMMARY

- The annual rate of real GNP growth in the first quarter of 1988 reached 2.3 percent, the U.S. Department of Commerce reported. While this rate was less than half the 4.8 percent advance recorded in the fourth quarter of 1987, it appears that enough of the economy's momentum in the latter half of 1987 has carried forward into 1988 to all but rule out the risk of a recession in 1988.
- Much of the concern over the prospect for faster rates of inflation in 1988 has centered on the outlook for higher wage increases this year. The most recent data shows that total compensation costs facing private firms are rising at a faster pace than last year. However, most of the increase was due to a legislated rise in the employer's social security tax rate, and was not due to a markedly faster increase in wages. As a result, consumer prices are expected to increase by 4.3 percent in 1988, compared with a 3.7 percent rise in 1987 (year-over-year basis).
- The monetary policy of the Federal Reserve appears to be directed at firming up short-term interest rates in order to calm growing inflation fears. The latest GNP report, showing the economy is in surprisingly good health, will likely hold the Fed to its tight money course, which could keep interest rates on an upward trend. The current forecast projects the FHA secondary market yield on a 30-year fixed rate mortgage to reach 10.4 percent in the current quarter, and average 10.5 percent for all of 1988.
- Sales of existing single-family homes reached a seasonally adusted annual rate of 3.33 million units in March, up 2.5 percent from the February annual rate of 3.25 million units. The February and March advances came as a result of lower interest rates and underlying demographic factors. Existing single-family home sales are expected to reach an annual rate of 3.31 million units in 1988, 6.0 percent less than the 1987 total of 3.53 million units. The 1988 total should rank as the third best year for existing home sales in the 1980's.

## IN THIS ISSUE


- Economic Commentary: PLAY BALL! by John A. Tuccillo
- Outlook for the Economy and Real Estate, by Sean A. Burns
- Trends in Housing and Urban Development Outlays & Budget Authority, by Frederick E. Flick
- Real Estate Profile: First-Time Homebuyers in the Spring 1988 Marketplace
- Highlights from *1988 Guide to Industrial and Office Real Estate Markets*


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# PLAY BALL!

## Economic Commentary

*by*
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Spring is a wonderful time because it means the return of baseball. Old men dressed like little boys play a game locked in the eternal freshness and optimism of a reborn world. In April, all teams (yes, even the Orioles) are pennant winners, and all players are most valuable. No small part of the enduring appeal of baseball is its association with spring, but there is an attraction in the very nature of the game. Set within a well defined geometric frame, and subject to a code of well-specified rules, the game unfolds as the result of a myriad of independent decisions taken freely by human beings operating within that framework. Indeed, the excesses of the game have a tendency to be self-correcting. If the hitters get ahead of the pitchers, someone invents and perfects a split-fingered fastball that reins in excessive power. If the pitchers get too smart, the offense runs and bunts more to build runs. It is no wonder that the great literate sports writers like Roger Angell and Thomas Boswell are attracted primarily to baseball. Its dimensions, outcomes and possibilities are endlessly fascinating. In short, it is a microcosm of life.

What prompts these musings is the recent success of trade protectionism, most visibly represented by the progress through Congress of a trade bill that would attempt to manage international economic relationships by "loading" the system in favor of the poor, downtrodden U.S. If baseball is analogous to the free market, where what's broke gets fixed automatically, then trade protectionism is equivalent to forcing Wade Boggs or Don Mattingly to bat blindfolded every other turn because they are more proficient hitters.

Let's push the analogy a bit further. In the 1950s, the Yankees were baseball's dominant team. But rather than force Mickey Mantle to run 120 feet to reach base, or make Whitey Ford pitch righthanded or even tape over Yogi Berra's mouth, baseball compensated by doing things that matched their excellence. The Yankee farm system worked, so other teams built theirs; the Yankees spent money on players, so other teams followed suit. Eventually because of their own efforts and because the New Yorkers got complacent and sloppy, other teams caught and passed the Yankees.

The lesson here is one that needs learning. We cannot and should not meet international competition by protecting our own uncompetitiveness. Doing so only intensifies the cause of the problem and precludes long-run and real solutions. The falling dollar is one element of the puzzle. As it deteriorates against the currencies of our trading partners, the demand for American products will automatically increase. We have seen this occurring over the past eighteen months as exports have steadily expanded. As we become overburdened by debt and are forced to save more, our appetite for foreign goods will diminish and imports will fall. We will see this as the year progresses.

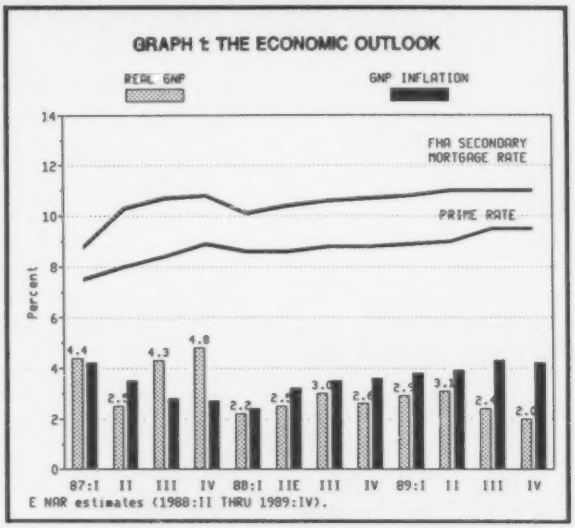
But merely relying on the rules of the game is not enough. To quote that famed double-play combination, Shakespeare to Cassius to Brutus, "The fault, dear Brutus, is not in the stars; it's in ourselves." Those teams -- Washington, Cleveland, the Chicago Cubs -- who did not learn about emulating the Yankees never achieved any degree of success. We need to alter our own methods of production, distribution and merchandise to meet international challenges. There are few, if any, secrets in the world of business. The Japanese, to give one example, outstripped the U.S. by improving on its methods, not by inventing new ones. We have the same opportunities. It is a challenge we will meet only by being willing to become more efficient, more productive and smarter than the next guy, within the context of the market and its rules. We cannot win by attempting to load the system in our favor through artificial restrictions.

Times change and what was up may soon be down -- ask any Baltimore Orioles devotee. Ten years ago, we worried about the Arabs owning all we had. Now we worry about the Japanese. It seems, however, that in this world of technological wizardry, it is the fate of the front runner to be picked off. We haven't had a repeat World Series winner in a decade, and maybe there will no longer be a single, dominant international economy. Maybe anyone who is willing to work hard and think deep thoughts has the chance to stand astride the market -- for a while. Remember, as that Great American philosopher, Satchel Paige, put it : "Don't look back; you never can tell who's gainin' on you."

# Outlook for the Economy and Real Estate

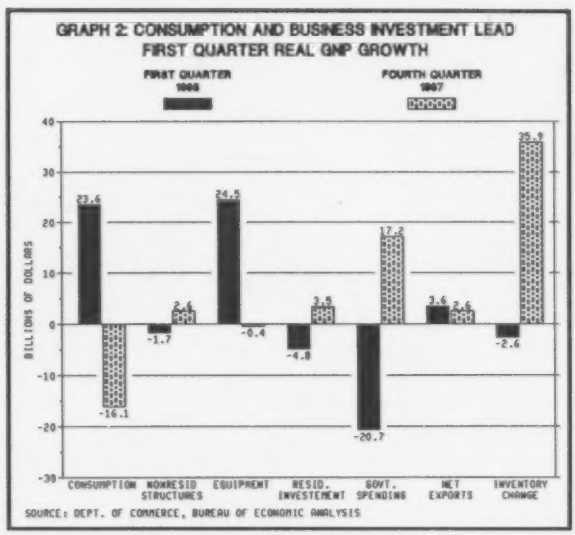
## THE ECONOMIC OUTLOOK

Well into its sixth year, the economic expansion advanced further in the first quarter of 1988, according to the most recently available economic indicators. The U.S. Department of Commerce reported that the annual rate of real GNP growth in the first quarter of 1988 reached 2.3 percent. While this rate was less than half the 4.8 percent advance recorded in the fourth quarter of 1987, it brought welcome reassurance that the effects of the stock market crash had not brought the economy to the brink of a recession. It now appears that enough of the economy's momentum in the latter half of 1987 has carried forward into 1988, yet probably not enough to push inflation up at a faster rate. However, the risk to this "just right" rate of economic growth may be a slowly improving trade deficit that could cause another slide in the dollar. The current forecast projects that real GNP will rise by 2.9 percent in 1988, with the second half of the year stronger than the first six months.


GRAPH 1: THE ECONOMIC OUTLOOK
REAL GNP
GNP INFLATION
FHA SECONDARY MORTGAGE RATE
PRIME RATE
Percent
87:I II III IV 88:I IIE III IV 89:I II III IV
E NAR estimates (1988:II THRU 1989:IV).

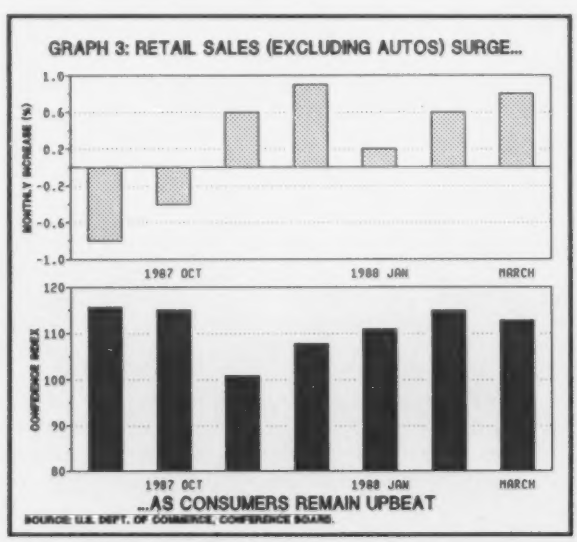
### Changing Composition of GNP Growth

Not only are the magnitudes of the fourth quarter and first quarter GNP numbers different, their compositions are much like mirror images of one another. While consumer spending fell sharply in the fourth quarter, its strong rebound in the first quarter explained most of the GNP advance. Similarly, business spending on equipment was almost flat in the fourth quarter, but it rivaled consumption spending for the role as sectoral leader in first quarter growth. Residential investment was off slightly in the first quarter report, after having risen in the fourth quarter. In sum, these and all other components of real final sales advanced at a 2.6 percent rate, after moving up by only 0.9 percent in the fourth quarter. The balance of the GNP growth rate is determined by the change in business inventory investment. A surge in export demand led to soaring business operating rates, but also helped create an inventory overhang. A production slowdown was expected to correct the inventory imbalance, but it proved milder than expected because of the indomitable spirit of the American consumer.




### Retail Sales Surge Ahead

Just prior to the stock market crash, consumers were riding high on good feelings about the prospects for continued economic growth. Much of that confidence was diluted in a few short hours last October. However, since that fateful afternoon consumer confidence has been on the mend, as measured by the Conference Board. Not surprisingly, consumer spending also is on the upswing again after slumping through much of 1987. In four of the last five months, retail sales (excluding the volatile auto component) have increased by rates much higher than the average monthly gain for 1987. These higher monthly advances are not just statistics: they translate into significant gains in real GNP, documented by the first quarter real GNP report. Consumer spending is expected to be a key component of successive quarterly growth in output during 1988. But the resurgence in consumer spending does carry with it some of its own pitfalls. Namely, as long as consumers are in the mood to spend they will likely also remain somewhat partial to imported goods.



### Employment Costs Could Rise

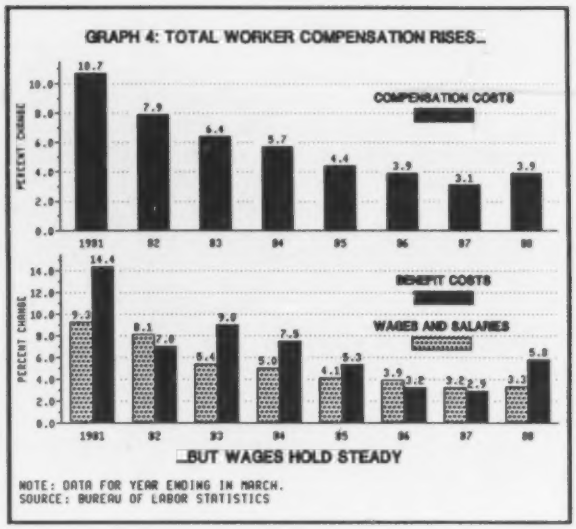
Much of the recent debate over the prospects for faster rates of inflation in 1988 has centered on the outlook for higher wage settlements. The most recent data on the subject does not support the notion that wage settlements will be much higher in 1988 than in 1987. This data came from the U.S. Bureau of Labor Statistics, which reported that the Employment Cost Index rose 4.1 percent for the year ended in March. The ECI index takes into account changes in total compensation costs, which include wages, salaries, and employer costs for employee benefits. Compensation costs for workers at private sector firms rose 3.9 percent in the 12 months ending in March, the first time that March-to-March compensation cost increases were faster than the previous year. However, the wages and salaries component of the index rose only 3.3 percent, only slightly higher than the 3.2 percent March 1987 gain. Instead, the biggest source of the private sector rise was benefit costs, which surged 5.8 percent, twice the 2.9 percent March 1987 rise. This acceleration was due to a legislated rise in the employer's social security tax rate from 7.15 to 7.51 percent, and steeper health insurance costs.

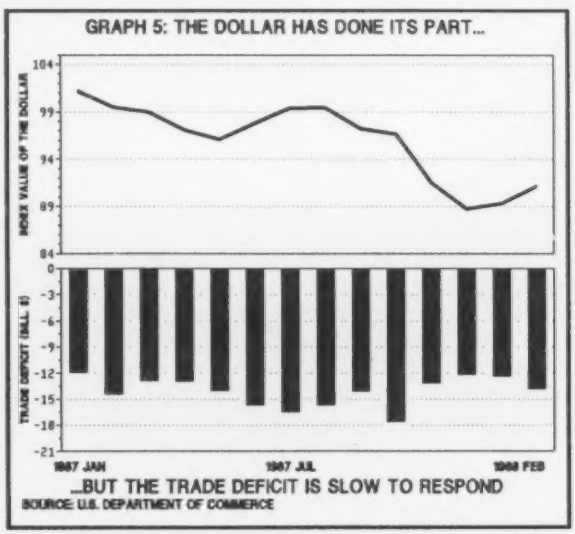
### Exports Grow, But Trade Deficit Persists

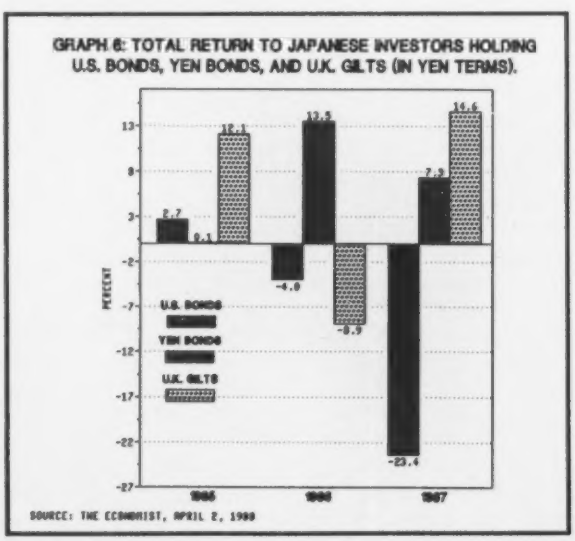
While most of the reports on the economy's health indicate clear sailing ahead, the monthly fluctuations in the trade deficit still are cause for some concern. According to the most recent data available, the February trade deficit widened to $13.8 billion, from $12.5 billion in January. This news raised concerns in the world's financial markets, and cast doubts over the effectiveness of renewed pledges for economic cooperation announced by the world's financial ministers the day preceding the trade report. However, the trend in trade is still positive: February exports rose to $23.6 billion, up from $22.3 billion in January. Most of the concern is focused on the import figures, which showed imports rising to $37.4 billion in February, from $34.8 billion in January. There is a message in these numbers. The trade deficit is improving, but it could be slowed by a resurgence of U.S. economic growth that boosts consumer incomes and demand for imports.

### Willingness to Hold Dollars Is Key

As U.S. consumers buy imports, the foreign producers of those imports must decide how to invest their earnings. U.S. dollar-denominated assets have been very attractive to foreign investors for a number of reasons, not the least of which is the interest rate differential. But the slow decline in the trade deficit has brought further declines in the dollar. As a result, many of these foreign investors have watched the foreign currency equivalent of their dollar investment fall. For example, a Japanese government bond offering a 4.5% return is more than 4% below the yield of a comparable U.S. Treasury. For a 10-year instrument, that differential provides enough cushion for a Japanese investor to absorb a 30% decline in the dollar's value against the yen. However, the dollar has declined by more than 30 percent, thereby pulling down the total return of these dollar-denominated assets. The risk is that these foreign investors could demand higher interest rates in order to continue to hold dollar investments.

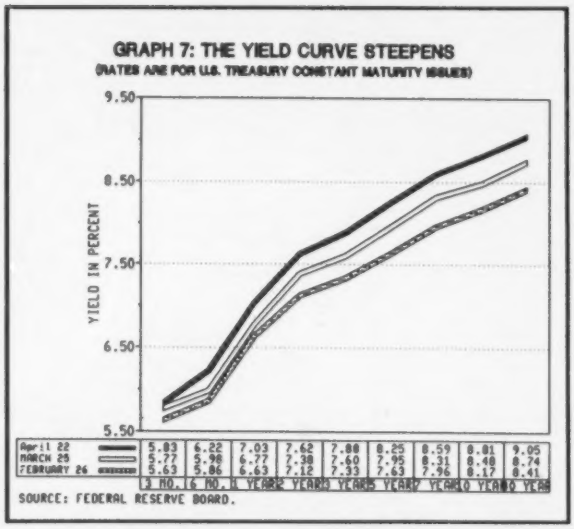




GRAPH 5: THE DOLLAR HAS DONE ITS PART...
INDEX VALUE OF THE DOLLAR
TRADE DEFICIT (BILL. $)
1987 JAN
1987 JUL
1988 FEB
...BUT THE TRADE DEFICIT IS SLOW TO RESPOND
SOURCE: U.S. DEPARTMENT OF COMMERCE

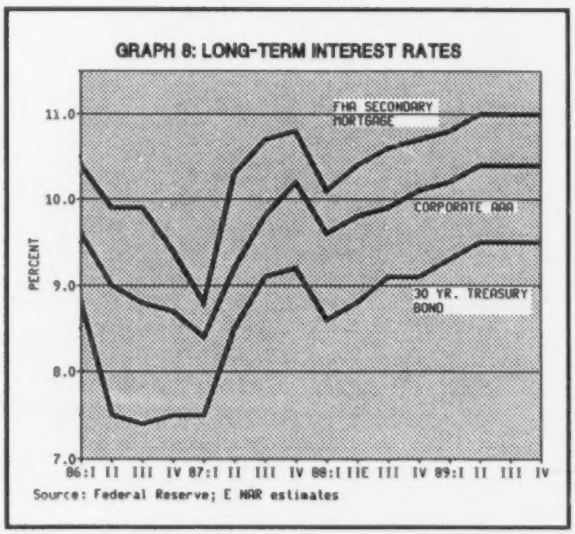


### Monetary Policy and Interest Rates

The accompanying graph of the yield curve shows how the Fed has been trying to hold the line on interest rates while keeping inflationary expectations in check. After the October stock market crash, the Fed provided enough money to meet the short-term demand for increased liquidity. Earlier this year, concerns about keeping the economy from falling into a recession led the Fed to postpone tightening up on the money supply. Recently, the Fed has been convinced that the economy is not at risk of falling into a recession. As a result, the Fed has tightened up on short-term interest rates, hoping to head off fears of rising inflation. The result of this has been a gradual shift upward in the yield curve over the last two months. In addition to the general shift, long-term interest rates (particularly sensitive to inflation fears) have risen steadily over the period, causing a marked steepening in the yield curve. The latest GNP report will likely hold the Fed to its tight money course aimed at stifling inflation.


GRAPH 7: THE YIELD CURVE STEEPENS
(RATES ARE FOR U.S. TREASURY CONSTANT MATURITY ISSUES)
YIELD IN PERCENT
9.50
8.50
7.50
6.50
5.50
April 22 5.03 6.22 7.03 7.62 7.88 8.25 8.59 8.81 9.05
MARCH 29 5.27 6.98 6.77 7.38 7.60 7.95 8.31 8.48 8.74
FEBRUARY 26 5.63 5.86 6.63 7.12 7.33 7.63 7.96 8.17 8.41
3 MO. 6 MO. 1 YEAR 2 YEARS 3 YEARS 5 YEARS 7 YEARS 10 YEARS 20 YEARS
SOURCE: FEDERAL RESERVE BOARD.

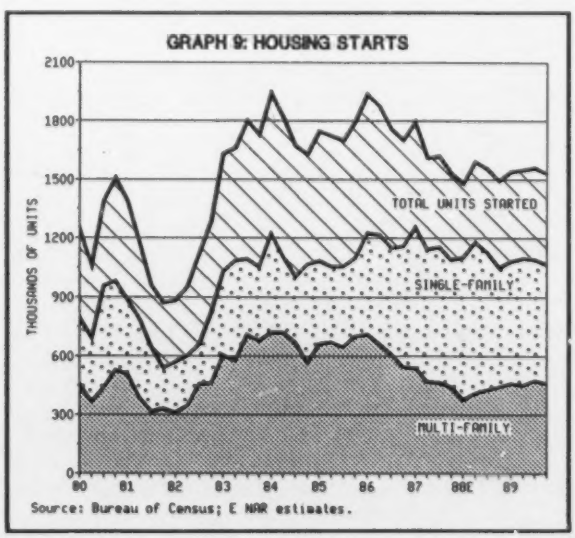
As the Fed follows this monetary policy tack, the financial markets will be keenly watching for signs of a resurgence of inflation. Chairman Greenspan's every public statement will be analyzed for his sentiments toward the rate of price change. If the financial markets detect a lessening of concern on his part regarding the inflation outlook, then it will likely cause even more inflation fears. Further, the slow improvement of the trade deficit will continue to grab the headlines and focus attention on the likelihood of further declines in the dollar. Consequently, the potential for long-term interest rates to gradually rise remains a cornerstone of this forecast. The probability that mortgage rates will be higher next year than they are now is significant. The current forecast projects the FHA secondary market yield on a 30-year fixed rate mortgage to reach 10.4 percent in the current quarter. That rate is expected to rise steadily during the remainder of the year, reaching an annual average of 10.5 percent for 1988. In the spring of 1989, that interest rate is expected to reach 11.0 percent.




## REAL ESTATE MARKETS

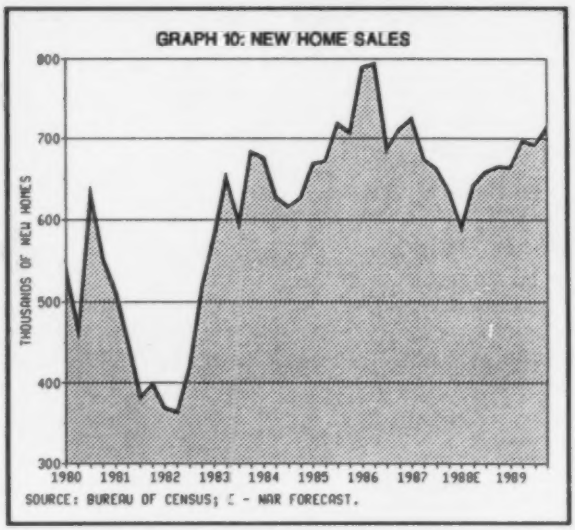
### Housing Starts

In March, privately owned housing units were started at a seasonally adjusted annual rate of 1.543 million units. This rate was 2 percent above the revised February rate of 1.514 million units. The March annual rate was 10 percent below the March 1987 annual rate of 1.723 million units. Starts of single-family units in March 1988 reached an annual rate of 1.185 million units, a rate 7 percent faster than the February pace of 1.106 million units. Multi-family units were started at an annual rate of 358 thousand units in March., 12.3 percent off the revised February pace of 408 thousand units. Housing starts activity was uneven on a regional basis, with the West region posting the only gain. This latest report on housing starts activity confirms that the housing sector is still robust, even this late in such a prolonged economic expansion. A combination of demographic factors and the potential for higher mortgage rates will likely push housing starts to an annual total of 1.53 million units in 1988.



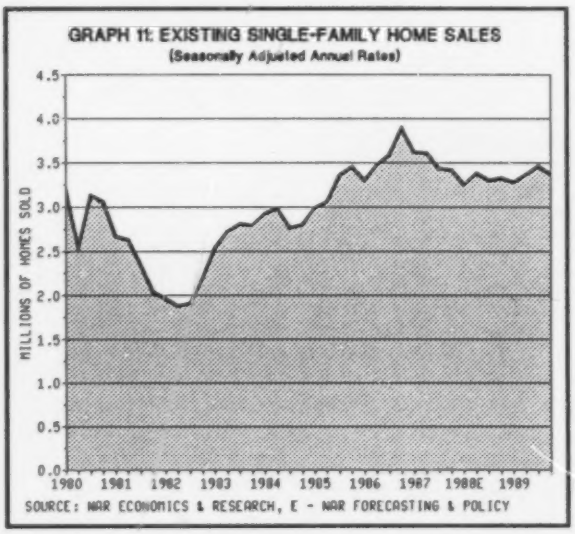
### New Home Sales

Sales of new single-family homes reached a seasonally adjusted annual rate of 655 thousand units in March, a 4.0 percent rise above the revised February annual rate of 630 thousand units. Previously, the annual rate of new single-family home sales had remained below 600 thousand units in December and January, at 586 and 552 thousand units, respectively. The welcome news on new home sales combined with the improving performance of housing starts activity helps frame a positive outlook for the spring buying and building season. The low mortgage interest rates available during March was the most significant factor leading to the resurgence in demand for new homes. There are also demographic trends powering home sales to levels that might appear unusually strong, this late in the housing cycle. The current forecast projects sales of new single-family homes to reach 639 thousand units in 1988, down 4.7 percent from the 1987 total.




### Existing Home Sales

Sales of existing single-family homes reached a seasonally adjusted annual rate of 3.33 million units in March, up 2.5 percent from the February annual rate of 3.25 million units, but down 9.8 percent from the March 1987 annual rate of 3.69 million units. On a regional basis, the February to March advance was concentrated in the West (9.6 percent increase) and the South (6.7 percent increase); sales in the Northeast were unchanged but were off slightly in the Midwest (3.4 percent decline). The number of existing single-family homes on the market reached 2.72 million in March, which, given the March sales pace, translates into a 9.8 month supply. Renewed vigor in existing home sales has been largely due to lower interest rates during the opening months of 1988. While mortgage rates are expected to gradually rise during 1988, two other factors are likely to keep the rate of existing home sales healthy. First, the popularity of adustable rate mortgages (ARM) is again on the rise. *The Home Financing Transaction: Spring 1988* report found that 31 percent of home purchases in its sample were financed with an ARM, compared to 8 percent during the same period last year. (A summary of this report appears in this issue.) Second, the demographics of housing demand point toward a sustained period of existing home sales at a rate of at least 3.2 million units. For these reasons, existing home sales are expected to reach an annual rate of 3.31 million units in 1988, 6.0 percent less than the 1987 total of 3.53 million units. At that annual rate, the 1988 total would rank as the third best year for existing home sales in the 1980's.




The modest slowing in demand for both existing and new homes in 1988 will not stall the rate of price increases on these properties. The median existing single-family home price is expected to rise by 5.4 percent in 1988. New home prices could rise by a faster rate of about 8.3 percent.

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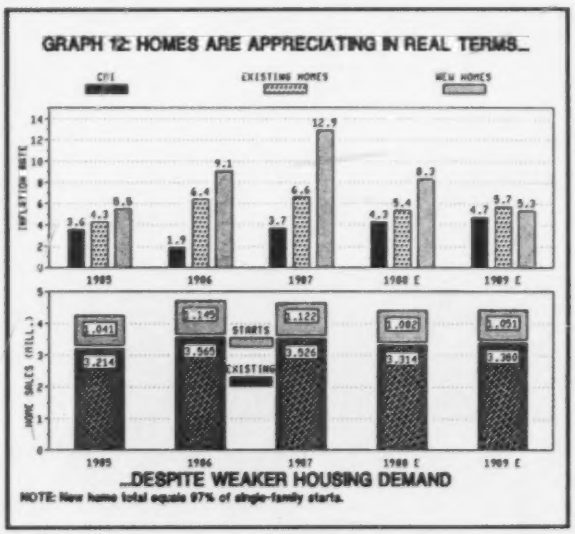


| | QUARTERS | | | | | | | YEARS | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Actual | | Forecast | | | | | Actual | | Forecast | |
| | 1987.4 | 1988.1 | 1988.2 | 1988.3 | 1988.4 | 1989.1 | 1989.2 | 1986 | 1987 | 1988 | 1989 |
| AGGREGATE ECONOMY | | | | | | | | | | | |
| Gross National Product (billions of dollars) | 4607 | 4661 | 4726 | 4801 | 4873 | 4953 | 5038 | 4235 | 4486 | 4765 | 5085 |
| % Change | 7.6 | 4.7 | 5.7 | 6.5 | 6.2 | 6.7 | 7.0 | 5.6 | 5.9 | 6.2 | 6.7 |
| % Change (w/out inflation) | 4.8 | 2.3 | 2.5 | 3.0 | 2.6 | 2.9 | 3.1 | 2.9 | 2.9 | 2.9 | 2.7 |
| Consumer Price Inflation (CPI) | 3.6 | 4.2 | 4.0 | 4.4 | 4.5 | 4.7 | 4.7 | 1.9 | 3.7 | 4.3 | 4.7 |
| GNP Inflation (GNP Deflator) | 2.7 | 2.4 | 3.2 | 3.5 | 3.6 | 3.8 | 3.9 | 2.6 | 3.0 | 3.2 | 3.9 |
| Unemployment Rate - Civilian | 5.9 | 5.6 | 5.7 | 5.8 | 5.9 | 5.9 | 5.9 | 7.0 | 6.2 | 5.8 | 5.9 |
| Civilian Employment-Household Basis (millions) | 113.5 | 114.2 | 114.7 | 115.1 | 115.6 | 115.9 | 116.2 | 109.6 | 112.4 | 114.9 | 116.6 |
| Percent change | 2.3 | 2.5 | 1.8 | 1.4 | 1.7 | 1.0 | 1.7 | 2.3 | 2.6 | 2.2 | 1.6 |
| Index of Industrial Production | 133.0 | 134.5 | 135.4 | 136.4 | 137.2 | 137.9 | 138.7 | 125.1 | 129.8 | 135.9 | 138.9 |
| Manufacturing Capacity Utilization | 82.2 | 82.4 | 82.6 | 82.8 | 82.8 | 83.0 | 83.2 | 79.7 | 81.0 | 82.7 | 83.1 |
| Domestic Auto Sales | 6.7 | 7.6 | 6.9 | 7.1 | 6.3 | 6.9 | 6.8 | 8.2 | 7.1 | 7.0 | 6.9 |
| Federal Tax Receipts (NIPA) as % of GNP | 20.4 | 20.1 | 20.2 | 20.1 | 20.3 | 20.6 | 20.6 | 19.5 | 20.4 | 20.2 | 20.6 |
| Federal Expenditures (NIPA) as % of GNP | 24.0 | 23.9 | 23.7 | 23.6 | 23.6 | 23.4 | 23.3 | 24.4 | 23.8 | 23.7 | 23.3 |
| Deficit (NIPA) | -165.9 | -175.0 | -164.5 | -165.0 | -161.2 | -137.7 | -133.2 | -204.7 | -152.8 | -166.4 | -134.7 |
| as % of GNP | -3.6 | -3.8 | -3.5 | -3.5 | -3.3 | -2.8 | -2.7 | -4.8 | -3.4 | -3.5 | -2.7 |
| REAL ESTATE MARKETS | | | | | | | | | | | |
| HOME SALES | | | | | | | | | | | |
| Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts) | 4467 | 4319 | 4525 | 4393 | 4344 | 4328 | 4429 | 4717 | 4649 | 4395 | 4314 |
| Percent change -- year ago | -10.9 | -10.9 | -4.5 | -3.5 | -2.8 | 0.2 | -2.1 | 10.9 | -1.4 | -5.5 | 0.8 |
| Existing Single-family Home Sales ($1000) | 3420 | 3250 | 3380 | 3300 | 3325 | 3280 | 3365 | 3565 | 3526 | 3314 | 3380 |
| Percent change -- year ago | -12.1 | -10.7 | -7.1 | -3.8 | -2.8 | 0.9 | -0.4 | 10.9 | -1.1 | -6.0 | 2.0 |
| Housing Starts (thousands) | 1533 | 1480 | 1590 | 1556 | 1493 | 1541 | 1549 | 1805 | 1634 | 1529 | 1546 |
| Percent change -- year ago | -10.7 | -16.8 | -1.0 | -3.9 | -2.6 | 6.3 | 1.7 | 3.6 | -9.8 | -7.8 | 2.6 |
| Single-Family Units | 1090 | 1102 | 1180 | 1127 | 1050 | 1081 | 1097 | 1179 | 1157 | 1115 | 1084 |
| Percent change -- year ago | -6.2 | -11.5 | 3.8 | -2.3 | -3.6 | 2.1 | -0.9 | 10.0 | -1.9 | -3.6 | -2.8 |
| Multi-Family Units | 443 | 377 | 410 | 429 | 443 | 460 | 451 | 631 | 477 | 415 | 462 |
| 2-4 Family Units | 56 | 56 | 58 | 55 | 58 | 59 | 57 | 84 | 66 | 57 | 59 |
| Percent change -- year ago | -35.3 | -29.1 | -19.5 | -1.5 | 2.0 | 17.5 | 8.7 | -10.1 | -21.2 | -13.9 | 3.9 |
| 5+ Family Units | 387 | 321 | 352 | 374 | 385 | 401 | 394 | 542 | 412 | 358 | 403 |
| Percent change -- year ago | -17.3 | -29.3 | -11.2 | -8.6 | -0.4 | 17.5 | 8.7 | -5.9 | -25.1 | -13.0 | 12. |
| New Single-family Home Sales (thousands) | 635 | 612 | 643 | 659 | 665 | 664 | 697 | 750 | 671 | 639 | 687 |
| Percent change -- year ago | -10.7 | -15.7 | -4.3 | -0.6 | 4.7 | 5.9 | 8.4 | 9.0 | -10.1 | -4.7 | 7.5 |
| Mobile Homes Shipped (thousands) | 232 | 210 | 225 | 241 | 245 | 246 | 249 | 249 | 233 | 230 | 249 |
| HOME PRICES | | | | | | | | | | | |
| Existing Home Prices - Median ($1000) | 84.4 | 88.1 | 89.8 | 90.6 | 92.5 | 93.4 | 94.0 | 80.3 | 85.6 | 90.3 | 95.4 |
| Percent change -- year ago | 5.2 | 4.5 | 5.5 | 6.0 | 9.6 | 7.6 | 7.7 | 6.4 | 6.6 | 5.4 | 5.7 |
| New Home Prices - Median ($1000) | 110.6 | 109.7 | 111.5 | 114.2 | 115.3 | 116.0 | 118.4 | 92.0 | 104.0 | 112.7 | 119.5 |
| Percent change -- year ago | 16.3 | 12.7 | 7.7 | 7.0 | 3.7 | 2.2 | 4.7 | 9.1 | 12.9 | 8.3 | 5.3 |
| FINANCIAL MARKETS | | | | | | | | | | | |
| Long-Term Interest Rates | | | | | | | | | | | |
| 30-yr FRM (FHA Secondary) | 10.8 | 10.1 | 10.4 | 10.6 | 10.7 | 10.8 | 11.0 | 9.9 | 10.2 | 10.5 | 11.0 |
| 1-year ARM (without buydown) | 8.2 | 7.5 | 7.3 | 7.3 | 7.5 | 7.7 | 8.0 | 7.9 | 8.2 | 7.4 | 8.0 |
| Corporate AAA Bond Rate | 10.2 | 9.6 | 9.8 | 9.9 | 10.1 | 10.2 | 10.4 | 9.0 | 9.4 | 9.9 | 10.4 |
| Government Bond Rate | 9.2 | 8.6 | 8.8 | 9.1 | 9.1 | 9.3 | 9.5 | 7.8 | 8.6 | 8.9 | 9.5 |
| Short-Term Interest Rates | | | | | | | | | | | |
| Federal Funds Rate | 6.9 | 6.7 | 6.9 | 7.1 | 7.2 | 7.3 | 7.4 | 6.8 | 6.7 | 7.0 | 7.4 |
| 3-month T-Bill Rate | 5.9 | 5.8 | 6.0 | 6.2 | 6.3 | 6.5 | 6.6 | 6.0 | 5.8 | 6.1 | 6.5 |
| Prime Rate | 8.9 | 8.6 | 8.6 | 8.8 | 8.8 | 8.9 | 9.0 | 9.2 | 8.6 | 8.9 | 9.5 |
| Discount Rate | 6.0 | 6.0 | 6.0 | 6.0 | 6.0 | 6.2 | 6.4 | 6.3 | 5.7 | 6.0 | 6.3 |
| Value of the U.S. Dollar (Trade-Weighted Avg.) | 92.3 | 90.0 | 88.0 | 86.5 | 85.4 | 84.7 | 83.8 | 112.3 | 96.9 | 87.5 | 82.7 |
| Percent change | -13.8 | -9.9 | -9.3 | -12.4 | -7.5 | -5.9 | -4.8 | -21.6 | -13.6 | -9.7 | -5.5 |

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick and Sean Burns.

# TRENDS IN HOUSING AND URBAN DEVELOPMENT OUTLAYS AND BUDGET AUTHORITY

*by*
Frederick E. Flick
*Division Vice President*
*Forecasting and Policy Analysis*

## Analyzing the Proposed Housing Budget

Last month we presented a big-picture look at the Administration's proposed budget outlays for Fiscal Years 1988 through 1991. In this analysis we will examine the proposed FY 1989 budget of the U.S. Department of Housing and Urban Development and focus on the trends in housing and community development program authority and outlays since 1976. We will analyze this by comparing some time trend data on various function and agency outlays.

Over the past decade, the HUD budget has suffered substantial cuts in program outlays and spending authority. Many analysts are now concluding that the effects of these cuts are showing up in the current problems of homelessness, high rent costs, and ultimately will affect the affordability of owner-occupied housing.

## Proposed HUD Authority/Outlays in the FY 1989 Budget

### Commerce and Housing Credit

The Commerce and Housing Credit function covers the HUD programs of the Government National Mortgage Association (GNMA), Federal Housing Administration (FHA), and housing for the elderly and handicapped.

- For GNMA in 1988, guarantees are expected to be issued on $83.4 billion in securities; and for 1989, the Administration proposes a new commitment limit of $100 billion, with new guarantee estimates of $83.6 billion.
- Housing for the Elderly and Handicapped. Currently, HUD makes direct loans to non-profit sponsors to finance the construction of housing for low-income elderly or handicapped residents. For 1988, the Congress has appropriated $566 million in direct loan authority, an amount estimated to be sufficient to finance the construction of over 11,000 units. The President has proposed funding of $350 million for 1989 to assist about 6,800 units. This level of assistance is projected for each year through 1993.

### Community and Regional Development

The Community and Regional Development function includes the HUD programs of Community Development Block Grants, Urban Development Action Grants, Rental Rehabilitation Grants, and Rental Housing Development Grants. The major budget proposals are:

- Community Development Block Grants. The Administration would reduce funding authority from the 1988 appropriation of $2.88 billion to $2.63 billion annually through 1993. However, outlays are still expected to be about $3 billion through 1990. Specific programs that would be terminated include Sec. 108 guaranteed loans and Sec. 312 rehabilitation loans.
- Urban Development Action Grants (UDAG). The UDAG program is slated to terminate at the end of 1989 with a $50 million rescission (reduction) in recaptured funds proposed in FY 1989. However, outlays in FY 1989 are expected to total $366 million due to the spendout of funds for projects approved in prior years.
- Rental Rehabilitation Grants (RRG). The Administration is proposing $150 million in new budget authority for 1989 and the two following years. This figure is down from the $200 million approved for FY 1988. Outlays in 1989 are estimated to be $238 million. The RRG program provides financial incentives to building owners to rehabilitate rental property for low-income families.
- Rental Housing Development Grants (HoDAGs). The program was created in 1983 to subsidize the construction or substantial rehabilitation of rental housing in low- and moderate-income neighborhoods with rental housing shortages. The 1987 Housing and Community Development Act calls for its termination at the end of FY 1989 and the Administration is proposing no further funding. Outlays in 1989 are estimated to be $109 million due to continuing payout on grants awarded in previous years. Those grants will not expire until 1991.

### Income Security

The Housing Assistance subfunction under the Income Security function provides housing subsidies for low-income families and individuals through several HUD programs. Eligibility for HUD assistance generally is limited to households with annual incomes below 50 percent of median income in each community. Specific Administration FY 1989 housing proposals include:

- A requested $8 billion in budget authority for 1989 to fund the low-income rental assistance programs. It proposes to provide five-year vouchers rather than fifteen- to twenty-year rental assistance contracts.

- One billion dollars in budget authority for modernizing public housing and $1.5 billion of operating subsidies for the almost 1.4 million public and Indian housing units.
- Funding the supportive housing demonstration for the homeless at $75 million in 1989 with all funds going to transitional housing where the homeless may live for up to 18 months.
- Approximately $50 million in new loan authority for projects for the mentally ill homeless under the Section 202/8 (includes Sec. 8 rent subsidies) program (new housing for the elderly and the handicapped).

### Budget Outlay Trends

As part of the annual budget, a set of tables with data on authorized amounts and outlays since 1976 is published for both budget function categories and individual agencies.* Since the great bulk of housing and community development programs are in the HUD budget, we will focus on the historical trend in HUD outlays, relative to those of other agencies.

In 1976, total federal government outlays were $371.8 billion. Military Defense accounted for $88 billion; Health and Human Services (including Social Security) was $120.2 billion; Treasury expenditures were $44 billion; and Agriculture, Labor and Veterans Administration (VA) outlays ranged from $17-$25 billion. The HUD budget was $7.0 billion or 2 percent of total outlays.

By 1980, Federal budget outlays totalled $590.9 billion with the following distribution (in billions) to selected departments: $130.9 - Military Defense; $194.2 - Health and Human Services (including Social Security); $76.5 - Treasury; Agriculture, Labor, and VA ranging from $21 to $35. HUD outlays were $12.7 billion, still averaging about 2.2 percent of the federal budget.

By 1987, the U.S. budget was $1.005 trillion, with the following outlays (in billions) for selected departments: $274 - Military Defense; $351.3 - Health and Human Services (including Social Security); $180.3 - Treasury; and $23-$50 for Labor, Transportation and Agriculture. The HUD outlay budget was $15.5 billion, but its share had dropped to 1.5 percent of total outlays. Under the Administration's current proposal, by 1989, HUD outlays would increase to 1.8 percent for 1988, then move to 2.0 percent through 1990.

### Budget Authority Trends

HUD outlays have been a relatively small part of the overall federal budget -- less than the Agriculture, Labor, VA, Transportation, and Education Departments. While HUD outlays as a percent of total outlays have experienced only a small decline since 1976, HUD has suffered the greatest declines in authority for future funding of existing programs or new programs.

In 1976, the total U.S. Government budget authority was $420.3 billion (outlays were $371.8 billion) and HUD authority was $29.2 billion. By 1980, HUD authority was $35.9 billion of a total $676.7 billion. By 1987 HUD authority had dropped to $14.7 billion while total budget authority had increased to $1.099 trillion.

Over the period 1976-1987 Military Defense authority increased from 22.7 percent to 25.4 percent of total authority, and reached as high as 27 percent in 1984. It is proposed to drop to 23.6 percent in 1989. Authority for Health and Human Services (including Social Security) has been as low as 28 percent of total authority. However, it climbed to 34 percent by 1987 and is projected to rise to 37 and 38 percent by 1989-1990.

### Cuts in the HUD Budget

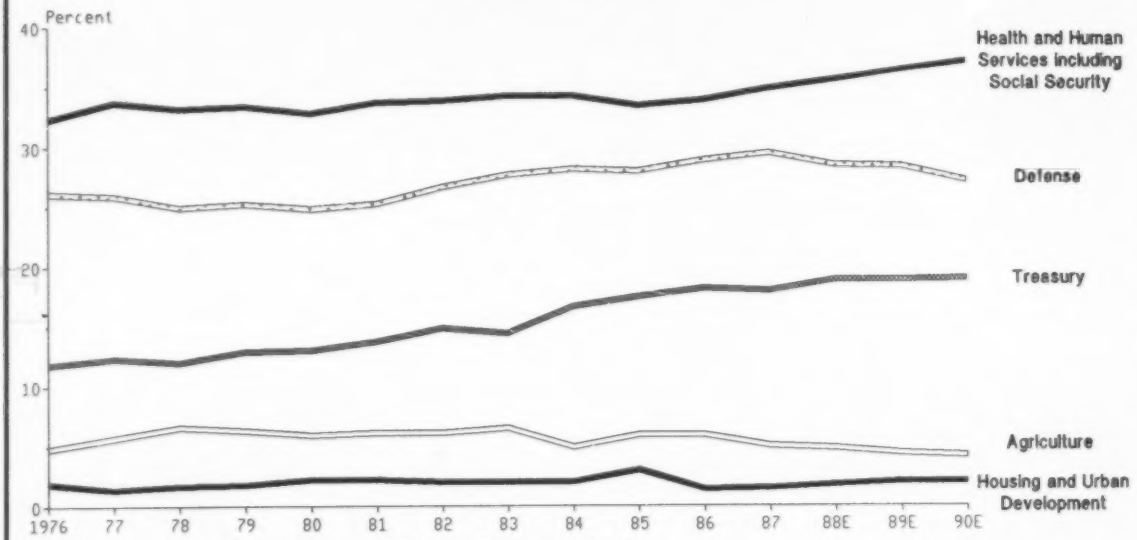
HUD authority, as a percent of total authority has been severely cut over these periods. In 1976 it was 6.9 percent of all authority and rose to 7 percent in 1977-1978. However, since 1980-1981 it has been steadily dropping so that now it has stabilized at about 1.3 percent of total budget authority. The largest cuts have been in the subsidized housing programs, especially those providing long-term rental subsidy contracts for low- to moderate-income tenants.

The substantial cuts in these programs, no doubt have exacerbated the affordability problem for renters and probably have contributed to the homelessness problem. HUD programs providing subsidies for maintaining public housing have also been cut as well as housing development and community development grants for localities.

*Historical Tables, Budget of the United States Government, Fiscal Year 1989, Executive Office of the President, Office of Management and Budget, (U.S. GPO, Washington, D.C.)

## PERCENTAGE OF BUDGET OUTLAYS: FY1976-FY1990

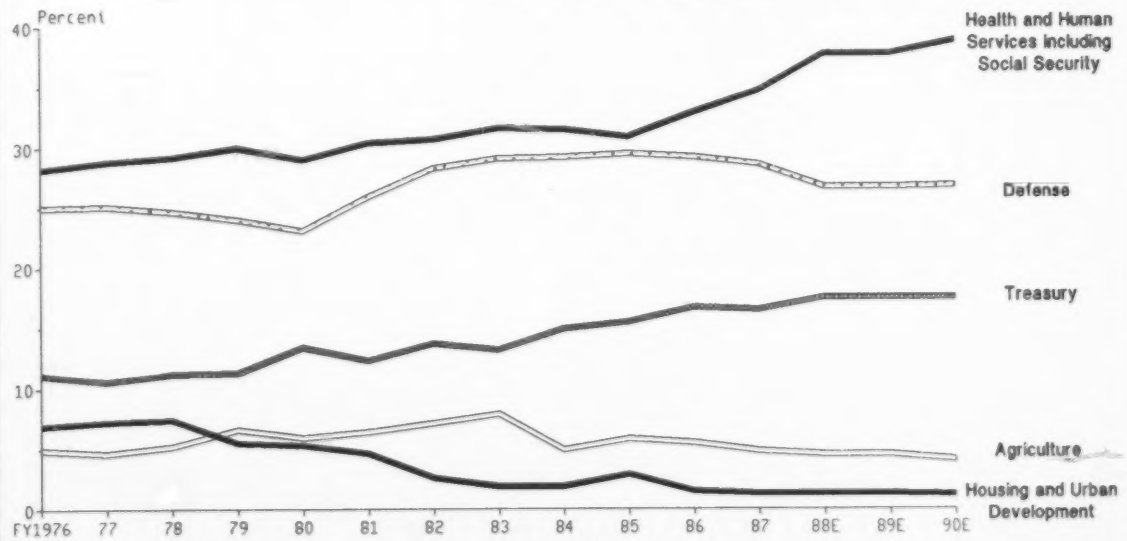
### SELECTED U.S. DEPARTMENTS




Source: Historical Tables, Budget of the U.S. Government, Fiscal Year 1989, Office of Managemaent and Budget.

## PERCENTAGE OF BUDGET AUTHORITY: FY1976-FY1990

### SELECTED U.S. DEPARTMENTS




Source: Historical Tables, Budget of the U.S. Government, Fiscal Year 1989, Office of Management and Budget.

**BUDGET OUTLAYS AND PERCENT OF TOTAL BY AGENCY: SELECTED FISCAL YEARS**

(dollars in billions)

| Department or other unit | 1976 | | 1980 | | 1984 | | 1987 | | Proposed 1988 | | 1989 | | 1990 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % | $ | % | $ | % | $ | % | $ | % |
| Legislative Branch | 0.94 | 0.2 | 1.32 | 0.2 | 1.78 | 0.2 | 1.88 | 0.2 | 1.91 | 0.2 | 2.12 | 0.2 | 2.18 | 0.2 |
| The Judiciary | 0.35 | 0.1 | 0.61 | 0.1 | 0.9 | 0.1 | 1.27 | 0.1 | 1.34 | 0.1 | 1.73 | 0.1 | 1.8 | 0.1 |
| Executive Office of the President | 0.07 | 0.0 | 0.1 | 0.0 | 0.11 | 0.0 | 0.12 | 0.0 | 0.13 | 0.0 | 0.13 | 0.0 | 0.13 | 0.0 |
| Funds Appropriated to The President | 10.93 | 2.6 | -0.73 | 2.0 | 18.95 | 2.0 | 13.0 | 1.2 | 10.47 | 0.9 | 10.63 | 0.9 | 11.14 | 0.9 |
| Agriculture | 20.76 | 4.9 | 39.63 | 5.9 | 46.82 | 4.9 | 52.52 | 4.8 | 59.87 | 4.5 | 55.49 | 4.5 | 53.54 | 4.1 |
| Commerce | 1.73 | 0.4 | 2.61 | 0.4 | 2.02 | 0.2 | 2.16 | 0.2 | 2.42 | 0.2 | 2.41 | 0.2 | 3.16 | 0.2 |
| Defense-Military | 95.50 | 22.7 | 140.65 | 22.7 | 258.18 | 27.2 | 281.44 | 25.4 | 283.16 | 23.6 | 290.78 | 23.6 | 307.29 | 23.7 |
| Defense-Civil | 9.52 | 2.3 | 15.24 | 2.3 | 19.23 | 2.0 | 35.14 | 3.2 | 36.89 | 3.1 | 38.46 | 3.1 | 40.37 | 3.1 |
| Education | 9.38 | 2.2 | 15.29 | 2.3 | 15.42 | 1.6 | 19.61 | 1.8 | 20.26 | 2.0 | 24.21 | 2.0 | 23.69 | 1.8 |
| Energy | 4.95 | 1.2 | 10.03 | 1.5 | 10.95 | 1.2 | 10.13 | 0.9 | 10.76 | 1.0 | 12.53 | 1.0 | 14.01 | 1.1 |
| Health and Human Services (except Social Security) | 48.21 | 11.5 | 78.86 | 11.7 | 128.0 | 13.5 | 159.7 | 214.5 | 176.7 | 315.5 | 191.4 | 215.5 | 203.2 | 915.6 |
| Health and Human Services (social security) | 70.16 | 16.7 | 116.75 | 17.3 | 171.43 | 18.0 | 221.99 | 20.2 | 251.47 | 22.2 | 273.34 | 22.2 | 301.33 | 23.2 |
| Housing and Urban Development | 29.2 | 6.9 | 35.85 | 5.3 | 18.15 | 1.9 | 14.66 | 1.3 | 15.41 | 1.3 | 16.15 | 1.3 | 16.04 | 1.2 |
| Interior | 2.74 | 0.7 | 4.68 | 0.7 | 4.91 | 0.5 | 5.28 | 0.5 | 5.44 | 0.4 | 4.79 | 0.4 | 2.67 | 0.2 |
| Justice | 2.18 | 0.5 | 2.47 | 0.4 | 3.46 | 0.4 | 5.21 | 0.5 | 5.38 | 0.5 | 6.16 | 0.5 | 6.19 | 0.5 |
| Labor | 20.46 | 4.9 | 28.8 | 4.3 | 34.83 | 3.7 | 30.25 | 2.8 | 31.47 | 2.6 | 31.71 | 2.6 | 30.54 | 2.4 |
| State | .94 | 0.2 | 2.14 | 0.3 | 2.98 | 0.3 | 3.77 | 0.3 | 3.74 | 0.3 | 3.84 | 0.3 | 4.16 | 0.3 |
| Transportation | 11.08 | 2.6 | 19.96 | 3.0 | 28.60 | 3.0 | 26.12 | 2.4 | 27.08 | 2.1 | 26.09 | 2.1 | 26.60 | 2.0 |
| Treasury | 46.63 | 11.1 | 90.51 | 13.4 | 141.64 | 14.9 | 181.86 | 16.5 | 198.97 | 17.5 | 215.75 | 17.5 | 227.40 | 17.5 |
| Environmental Protection Agency | 0.77 | 0.2 | 4.67 | 0.7 | 4.06 | 0.4 | 5.34 | 0.5 | 4.96 | 0.4 | 4.68 | 0.4 | 4.61 | 0.4 |
| General Services Administration | 0.28 | 0.1 | 0.29 | 0.1 | 0.25 | 0.0 | 0.28 | 0.0 | -0.01 | 0.0 | 0.03 | 0.0 | 0.03 | 0.0 |
| National Aeronautics and Space Administration | 3.55 | 0.8 | 5.35 | 0.8 | 7.46 | 0.8 | 10.92 | 1.0 | 8.93 | 0.9 | 11.49 | 0.9 | 13.35 | 1.0 |
| Office of Personnel Management | 13.56 | 3.2 | 24.92 | 3.7 | 37.7 | 4.0 | 44.78 | 4.1 | 47.68 | 4.1 | 50.46 | 4.1 | 53.43 | 4.1 |
| Small Business Administration | 0.62 | 0.1 | 2.15 | 0.3 | 0.97 | 0.1 | 0.6 | 0.1 | 0.48 | 0.1 | 0.78 | 0.1 | 0.81 | 0.1 |
| Veterans Administration | 19.65 | 4.1 | 21.18 | 3.1 | 26.48 | 2.8 | 27.36 | 2.5 | 28.13 | 2.4 | 30.1 | 2.4 | 30.88 | 2.4 |
| Other Independent Agencies | 18.28 | 4.3 | 31.22 | 4.6 | 17.0 | 1.8 | 18.79 | 1.7 | 20.34 | 1.4 | 17.79 | 1.4 | 17.31 | 1.3 |
| Undistributed Offsetting Receipts | -22.17 | -5.3 | -31.99 | -4.7 | -52.33 | -5.5 | -72.31 | -6.6 | -77.72 | -7.3 | -89.86 | -7.3 | -97.83 | -7.5 |
| Total Outlays | 420.25 | 100.0 | 676.70 | 100.0 | 949.9 | 100.0 | 1099.89 | 100.0 | 1175.69 | 100.0 | 1233.15 | 100.0 | 1299.05 | 100.0 |

Source: Historical Tables, Budget of the U.S. Government, Fiscal Year 1989, Executive Office of the President, Office of Management and Budget, (U.S. GPO, Washington, D.C.).

**BUDGET AUTHORITY AND PERCENT OF TOTAL BY AGENCY: SELECTED FISCAL YEARS**

(dollars in billions)

| Department or other unit | 1976 | | 1980 | | 1984 | | 1987 | | Proposed 1988 | | Proposed 1989 | | Proposed 1990 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | $ | % | $ | % | $ | % | $ | % | $ | % | $ | % | $ | % |
| Legislative Branch | 0.94 | 0.2 | 1.32 | 0.2 | 1.78 | 0.2 | 1.88 | 0.2 | 1.91 | 0.2 | 2.12 | 0.2 | 2.18 | 0.2 |
| The Judiciary | 0.35 | 0.1 | 0.61 | 0.1 | 0.9 | 0.1 | 1.27 | 0.1 | 1.34 | 0.1 | 1.73 | 0.1 | 1.8 | 0.1 |
| Executive Office of the President | 0.07 | 0.0 | 0.1 | 0.0 | 0.11 | 0.0 | 0.12 | 0.0 | 0.13 | 0.0 | 0.13 | 0.0 | 0.13 | 0.0 |
| Funds Appropriated to The President | 10.93 | 2.6 | -0.73 | 2.0 | 18.95 | 2.0 | 13.0 | 1.2 | 10.47 | 0.9 | 10.63 | 0.9 | 11.14 | 0.9 |
| Agriculture | 20.76 | 4.9 | 39.63 | 5.9 | 46.82 | 4.9 | 52.52 | 4.8 | 59.87 | 4.5 | 55.49 | 4.5 | 53.54 | 4.1 |
| Commerce | 1.73 | 0.4 | 2.61 | 0.4 | 2.02 | 0.2 | 2.16 | 0.2 | 2.42 | 0.2 | 2.41 | 0.2 | 3.16 | 0.2 |
| Defense-Military | 95.50 | 22.7 | 140.65 | 22.7 | 258.18 | 27.2 | 281.44 | 25.4 | 283.16 | 23.6 | 290.78 | 23.6 | 307.29 | 23.7 |
| Defense-Civil | 9.52 | 2.3 | 15.24 | 2.3 | 19.23 | 2.0 | 35.14 | 3.2 | 36.89 | 3.1 | 38.46 | 3.1 | 40.37 | 3.1 |
| Education | 9.38 | 2.2 | 15.29 | 2.3 | 15.42 | 1.6 | 19.61 | 1.8 | 20.26 | 2.0 | 24.21 | 2.0 | 23.69 | 1.8 |
| Energy | 4.95 | 1.2 | 10.03 | 1.5 | 10.95 | 1.2 | 10.13 | 0.9 | 10.76 | 1.0 | 12.53 | 1.0 | 14.01 | 1.1 |
| Health and Human Services (except Social Security) | 48.21 | 11.5 | 78.86 | 11.7 | 128.0 | 13.5 | 159.7 | 214.5 | 176.7 | 315.5 | 191.4 | 215.5 | 203.2 | 915.6 |
| Health and Human Services (social security) | 70.16 | 16.7 | 116.75 | 17.3 | 171.43 | 18.0 | 221.99 | 20.2 | 251.47 | 22.2 | 273.34 | 22.2 | 301.33 | 23.2 |
| Housing and Urban Development | 29.2 | 6.9 | 35.85 | 5.3 | 18.15 | 1.9 | 14.66 | 1.3 | 15.41 | 1.3 | 16.15 | 1.3 | 16.04 | 1.2 |
| Interior | 2.74 | 0.7 | 4.68 | 0.7 | 4.91 | 0.5 | 5.28 | 0.5 | 5.44 | 0.4 | 4.79 | 0.4 | 2.67 | 0.2 |
| Justice | 2.18 | 0.5 | 2.47 | 0.4 | 3.46 | 0.4 | 5.21 | 0.5 | 5.38 | 0.5 | 6.16 | 0.5 | 6.19 | 0.5 |
| Labor | 20.46 | 4.9 | 28.8 | 4.3 | 34.83 | 3.7 | 30.25 | 2.8 | 31.47 | 2.6 | 31.71 | 2.6 | 30.54 | 2.4 |
| State | .94 | 0.2 | 2.14 | 0.3 | 2.98 | 0.3 | 3.77 | 0.3 | 3.74 | 0.3 | 3.84 | 0.3 | 4.16 | 0.3 |
| Transportation | 11.08 | 2.6 | 19.96 | 3.0 | 28.60 | 3.0 | 26.12 | 2.4 | 27.08 | 2.1 | 26.09 | 2.1 | 26.60 | 2.0 |
| Treasury | 46.63 | 11.1 | 90.51 | 13.4 | 141.64 | 14.9 | 181.86 | 16.5 | 198.97 | 17.5 | 215.75 | 17.5 | 227.40 | 17.5 |
| Environmental Protection Agency | 0.77 | 0.2 | 4.67 | 0.7 | 4.06 | 0.4 | 5.34 | 0.5 | 4.96 | 0.4 | 4.68 | 0.4 | 4.61 | 0.4 |
| General Services Administration | 0.28 | 0.1 | 0.29 | 0.1 | 0.25 | 0.0 | 0.28 | 0.0 | -0.01 | 0.0 | 0.03 | 0.0 | 0.03 | 0.0 |
| National Aeronautics and Space Administration | 3.55 | 0.8 | 5.35 | 0.8 | 7.46 | 0.8 | 10.92 | 1.0 | 8.93 | 0.9 | 11.49 | 0.9 | 13.35 | 1.0 |
| Office of Personnel Management | 13.56 | 3.2 | 24.92 | 3.7 | 37.7 | 4.0 | 44.78 | 4.1 | 47.68 | 4.1 | 50.46 | 4.1 | 53.43 | 4.1 |
| Small Business Administration | 0.62 | 0.1 | 2.15 | 0.3 | 0.97 | 0.1 | 0.6 | 0.1 | 0.48 | 0.1 | 0.78 | 0.1 | 0.81 | 0.1 |
| Veterans Administration | 19.65 | 4.1 | 21.18 | 3.1 | 26.48 | 2.8 | 27.36 | 2.5 | 28.13 | 2.4 | 30.1 | 2.4 | 30.88 | 2.4 |
| Other Independent Agencies | 18.28 | 4.3 | 31.22 | 4.6 | 17.0 | 1.8 | 18.79 | 1.7 | 20.34 | 1.4 | 17.79 | 1.4 | 17.31 | 1.3 |
| Undistributed Offsetting Receipts | -22.17 | -5.3 | -31.99 | -4.7 | -52.33 | -5.5 | -72.31 | -6.6 | -77.72 | -7.3 | -89.86 | -7.3 | -97.83 | -7.5 |
| Total Authority | 420.25 | 100.0 | 676.70 | 100.0 | 949.9 | 100.0 | 1099.89 | 100.0 | 1175.69 | 100.0 | 1233.15 | 100.0 | 1299.05 | 100.0 |

Source: Historical Tables, Budget of the U.S. Government, Fiscal Year 1989, Executive Office of the President, Office of Management and Budget, (U.S. GPO, Washington, D.C.).

# A Real Estate Profile: First-Time Homebuyers in the Spring 1988 Marketplace

More than one-third (38 percent) of homes purchased this Spring were bought by first-time homebuyers, according to the most recent Residential Mortgage Finance Panel Survey conducted by the Real Estate and Finance Division of the NATIONAL ASSOCIATION OF REALTORS®. The survey, whose results will be released early this month in *The Home Financing Transaction: Spring 1988* report, found that these new property owners exhibited dramatically different financial and household characteristics from repeat homebuyers.

The Spring 1988 survey results, which reflect mortgage activity from mid-March to mid-April, were reported by a panel of expert residential real estate brokers who are members of the NATIONAL ASSOCIATION OF REALTORS® . These brokers report information three times each year to provide the only publicly available information on the specific techniques, instruments, and sources of financing used to purchase residential property. Characteristics of the buyer and the property are also reported. Highlights of the Spring 1988 survey are presented below.

## SPRING 1988 HIGHLIGHTS

### Financial Characteristics

The average first-time homebuyer paid $84,100 for a home with a first mortgage amount of $74,100 for an average LTV of 90.50 percent. In contrast, repeat homebuyers bought substantially more expensive homes with proportionally larger downpayments. The repeat buyer paid an average of $126,900 on a home with a $93,700 first mortgage, an average LTV of 77.39 percent.

First-time homebuyers were charged a slightly higher average mortgage interest rate this Spring than were repeat homebuyers -- 9.46 percent compared to 9.22 percent. This reflects the fact that first-time homebuyers were much more likely to use a fixed-rate mortgage (FRM) to finance their purchase than were repeat homebuyers. In fact, 73 percent of first-time homebuyers used a FRM to finance their home purchase, and only 24 percent using an ARM. In contrast, 62 percent of repeat homebuyers used an FRM, while 35 percent financed their home with an ARM.

### Mortgage Insurance

The largest segment of first-time homebuyers used FHA insurance to insure their first mortgage. Specifically, 35 percent of first-time homebuyers used FHA insurance, 18 percent used a VA guarantee, and 21 percent used private mortgage insurance. State bonding agencies and other sources of mortgage insurance accounted for 2 percent of transactions. Less than one-quarter, or 23 percent, of first mortgages did not require mortgage insurance.

In contrast, close to two-thirds of repeat homebuyers did not use mortgage insurance. FHA insured 11 percent of first mortgages, and VA guaranteed only 5 percent of first mortgages for these buyers. The most popular source of mortgage insurance with repeat buyers was private mortgage insurance, which accounted for 21 percent of the transactions.

### Household Characteristics

Three out of ten first-time homebuyers were singles -- 16 percent single males and 14 percent single females, with unmarried couples accounting for an additional 8 percent. A full 61 percent of first-time homebuyers were married couples. By contrast, 79 percent of repeat homebuyers were married, with only 8 percent single males and 11 percent single females.

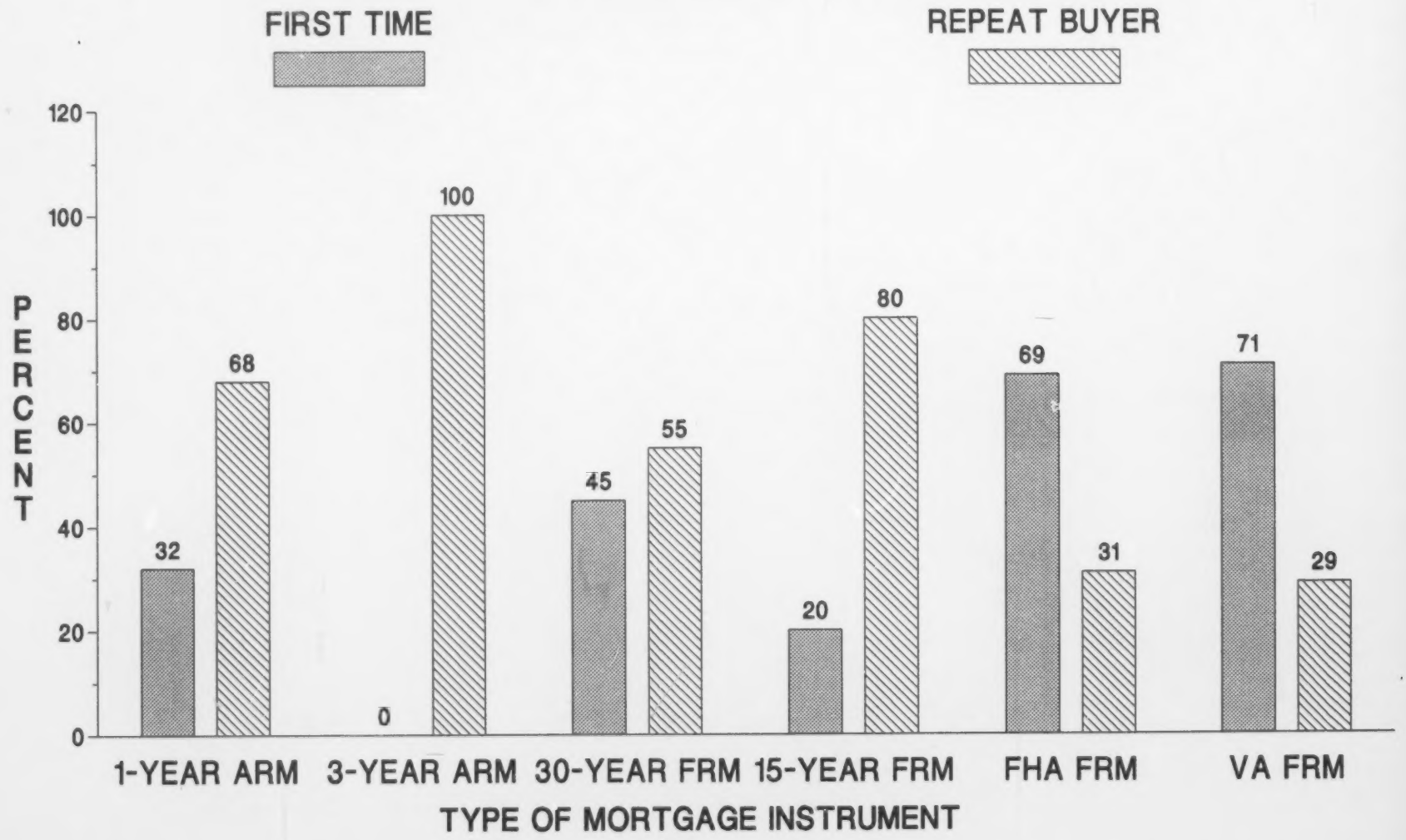
Not surprisingly, 80 percent of first-time homebuyers were just changing residences within the metropolitan area. Of the 20 percent of the first-time homebuyers new to the area, half were as a result of corporate relocation.

Just 54 percent of repeat homebuyers were changing residences in the metro area, and 33 percent were new to the area, 22 percent due to corporate relocation. An additional 11 percent of repeat homebuyers were reported to have bought their current purchases for investment purposes.

The median income of the first-time homebuyer during Spring 1988 was $35,700. Repeat homebuyers had a substantially larger median income of $50,000.

Repeat buyers were almost a full 10 years older than first-time buyers. The median age of the first-time homebuyer was 29.3 years, compared to 39.0 years for repeat homebuyers.

# CHARACTERISTICS OF THE BUYER SPRING 1988
# FIRST TIME VERSUS REPEAT HOMEBUYERS



# SIOR PUBLISHES INDUSTRIAL AND OFFICE GUIDE

The Society of Industrial and Office REALTORS® (SIOR) recently published the *1988 Guide to Industrial and Office Real Estate Markets*. The publication includes reviews of industrial real estate in 105 metropolitan markets and office real estate in 97 metropolitan markets. The 270 page document also includes a 1987 review and 1988 forecast of the economy and the real estate industry. This annual research project is a joint effort of SIOR and the Division of Economics and Research of the NATIONAL ASSOCIATION OF REALTORS®.

## ISSUES AND TRENDS

In the wake of tax reform and the widespread oversupply of office and industrial space in many metropolitan areas, real estate professionals have come to "focus on the fundamentals." This reevaluation of decision criteria for real estate development and investment does not, however, mean an end to innovation and change within the industry, but transactions will be more carefully scrutinized in 1988.

At this juncture, it appears highly probable that 1988 will be a year of slow growth, moderate inflation, stable interest rates, improving trade balances, and an opportunity to make some headway on the federal budget deficit. Based on these conclusions, 1988 should allow for some progress in many metropolitan areas that are saddled with excess office and industrial space.

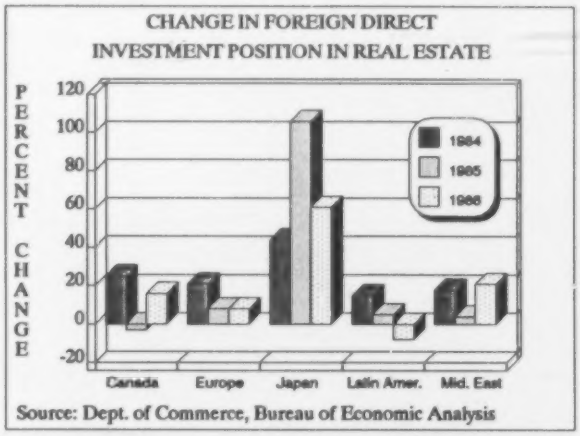
It would be disingenuous to forecast progress for all areas, but: 1) the industrial sector of the economy is remarkably strong; 2) interest rates are fairly stable and will move up very little unless inflation escalates unexpectedly; and 3) when a well-located, Class A product is available, there are a lot of investors looking to buy.

The real estate activities of large institutional investors and foreign investors have become a major preoccupation with the real estate press. While pension funds have over one trillion dollars worth of asssets, only approximately 3.5 percent of their assset mix consists of real estate equity. But even if the share of pension fund assets hasn't changed much, real commitments have increased because of a growing pool of total assets. Institutions are in the market for quality properties but real increases in allocation targets are not expected because the funds cannot find an adequate supply of satisfactory properties and new development is often hard to justify in most markets.

Large institutional investors and foreign investors place a large premium on top quality real estate. There has been only marginal interest in anything but Class A properties in top tier markets. There are signs, however, that fund mangers and offshore investors are taking a hard look at more types of properties and second tier cities. Escalating prices in the popular coastal cities and an apparent resurgence of the industrial belt have led several real estate analysts to suggest diversification decisions will be made on the basis of economic criteria instead of limited geographic criteria. Clearly, smaller markets and quality industrial properties stand to benefit.

Foreign investment continues to be the hottest topic in office and industrial real estate circles. Most observers believe the process of transferring ownership of real property from domestic to foreign owners will continue at a rapid pace. Progress on the budget and trade deficits is real but serious imbalances remain. There will continue to be a large pool of offshore money searching real estate markets for a good return on investment.

Western European and Canadian investors own the largest share of total real estate assets but Japanese investors are increasing their holdings at such a rapid pace that they are the focus of intense public scrutiny right now. Japanese investment grew 233 percent during the three year period between 1984 and 1986. Private estimates of Japanese purchases in 1987 alone range from $6 to $10 billion.



Source: Dept. of Commerce, Bureau of Economic Analysis

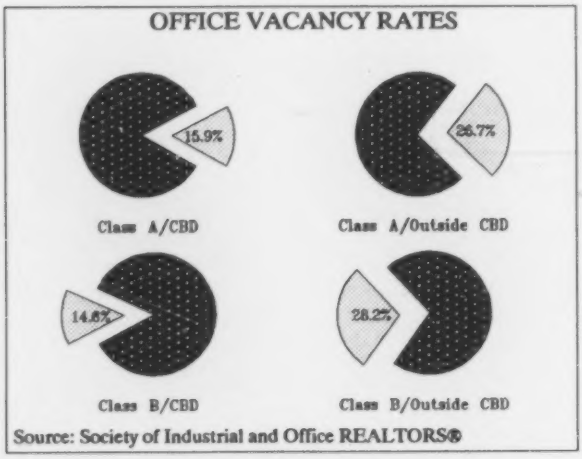
Like institutional investors, foreign investors generally invest in centrally located, top quality buildings. During the past two years, the Japanese have made several purchases of trophy properties, paying record prices and provoking the American public's curiosity about their intentions. They prefer office buildings and resort hotels located primarily in a few coastal cities and Hawaii. Large Japanese insurance and financial corporations have developed business relationships with American companies with expertise in real estate development, finance, acquisition, and management. There is little doubt that the Japanese will continue to agressively aquire real property in the United States.

## OFFICE MARKETS

Office markets in 1987 were characterized by stabilizing conditions in several weak markets in the Southwest and a strong performance by several vital markets on the coasts and in the Midwest. SIOR panelists in 97 markets provided information on over 2.5 billion square feet of office space.

The overall vacancy rate for the complete inventory of rentable office space nationwide is 21.7 percent. Class

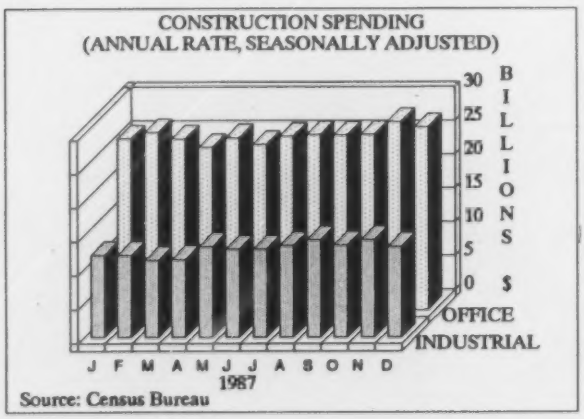
A/Central Business District (CBD) space has a vacancy rate of 15.9 percent. Class A space outside the CBD is 26.7 percent vacant. Class B vacancy rates are 14.6 percent for CBD space and 28.2 percent for space outside the CBD.



Source: Society of Industrial and Office REALTORS®

Vacancy rates were particularly high in areas that are having to weather local or regional economic distress or, in market areas that have recently experienced a surge in construction activity. Several markets reported comparatively low vacancy rates, led by Albany where only 4.32 percent of Class A space is vacant.

Office construction declined 12.6 percent in 1987 which is a much milder decline than many analysts had predicted. Approximately 175 million square feet of new space was completed in 1987. Most forecasters are still pessimistic about prospects for 1988 and expect the value of new construction to be off anywhere from 15 to 25 percent.



Source: Census Bureau

In several glutted markets, there has been little or no new construction activity. Slow, steady absorption has stabilized conditions in cities such as Dallas, Denver, and New Orleans. However, there are several reports of move-up tenants abandoning Class B and C space for heavily discounted Class A space.

Absorption was especially strong in the Northern New Jersey and Atlanta markets. The consolidated metropolitan areas of New York City, Los Angeles, and Washington, D.C. have been perennial absorption leaders the past few years and that held true for 1987.

Demand for office space will depend, of course, on the growth of employment in office-intensive industries. Most studies of office employment suggest that growth will continue in 1988 but at a slower pace. One of the often overshadowed impacts of the stock market adjustment was the effect it has had on employment in financial services. Employment growth generated by the success of Wall Street firms during the current expansion has most likely ended.

A majority of SIOR panelists expect 1988 to be a year of stability and slow recovery in their office markets. Nationwide, absorption will increase by less than five percent and rental rates will be flat. Over 40 percent of panelists expect vacancy rates to fall, due in part to declining construction activity. But areas with large concentrations of financial services employment could be adversely affected by a contraction in that office-intensive industry.

## INDUSTRIAL MARKETS

The technical signals on the industrial market are very positive and 1988 should be a strong year. Between 30 and 40 percent of the panelists in 105 markets surveyed by SIOR report moderate or substantial shortages of space in one or more building-size categories (Seven categories encompassing less than 5,000 sq. ft. to more than 100,000 sq. ft.).

The heightened prospects for increases in net exports coupled with increasing business investment in equipment bodes well for industrial property demand. Markets on the coasts where trade flows are a significant factor will continue to experience escalating property values and strong demand. This year, however, with the renewel of America's basic industries and renewed strength in the computer and electronics industries, the prospects for vital market conditions are more broad-based.

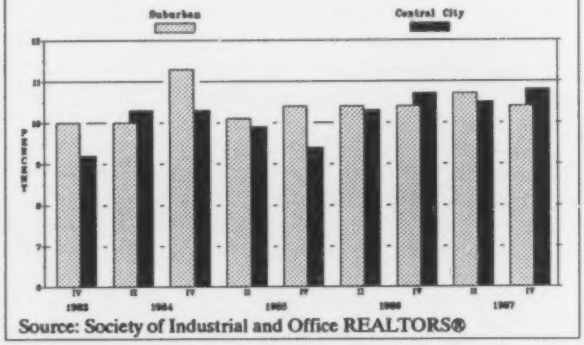
SIOR panelists in cities such as Minneapolis, Cincinnati, and St. Louis report a significant increase in activity. The beleaguered high technology component of the industrial market will remain immensely oversupplied, but 1988 will bring positive absorption in that sector, allowing vacancies to decline.

Despite an overall decline of 7.9 percent in the value of industrial construction in 1987, there were significant increases of new space in several markets. Atlanta added a remarkable 7,483,000 square feet to its inventory in 1987. Construction was also very strong in San Diego, Seattle, and Boston. As has been the case for several years, construction is heavily concentrated in suburban areas.

Strong absorption, especially of warehouse and distribution space, was widespread in 1987. The rapidly growing market of Los Angeles–San Fernando recorded approximately five million square feet of absorption. Other markets with strong absorption include Boston, San Diego, Cincinnati, Minneapolis/St. Paul, Atlanta, and Los Angeles–East.

The SIOR vacancy rate for centrally located industrial buildings increased 0.3 percent to 10.7 percent during the first half of 1987 before sliding back down to 10.4 percent in the fourth quarter. The suburban vacancy index moved up 0.2 percent early in the year to 10.5 percent and then increased another 0.3 percent to finish the year at 10.8 percent.

INDUSTRIAL VACANCY RATES




Source: Society of Industrial and Office REALTORS®

Tight industrial markets are not confined to any geographic area. From Greenville in the South, Reno in the West, and Cincinnati in the Midwest, several areas are experiencing shortages of industrial space.

The SIOR lease price indexes for all building categories except high-tech properties showed steady increases during 1987. Price increases were especially strong during the last half of the year.

Sales prices generally increased moderately early in the year but declined during the third and fourth quarters. Centrally located properties were more adversely affected than suburban properties.

In summary, industrial real estate is poised for another good year in 1988. Manufacturing firms are on the verge of increased space requirements. High-tech space is still oversupplied but high technology industries are experiencing growth again. And warehousing and distribution space demand is still strong. New industrial space can be delivered quickly and the industrial market is, as always, vulnerable to a recession. But a recession this year is unlikely. Instead, export-led growth will stimulate manufacturing and increase demand for industrial real estate products and services.

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